MOODY'S
INVESTORS SERVICE

CREDIT OPINION
13 March 2017

Update

Rate this Research

Sparebanken Sogn og Fjordane

Regular Update

RATINGS

Sparebanken Sogn og Fjordane

Domicile	Norway
Long Term Debt	Not Assigned
Type	Not Assigned
Outlook	Not Assigned
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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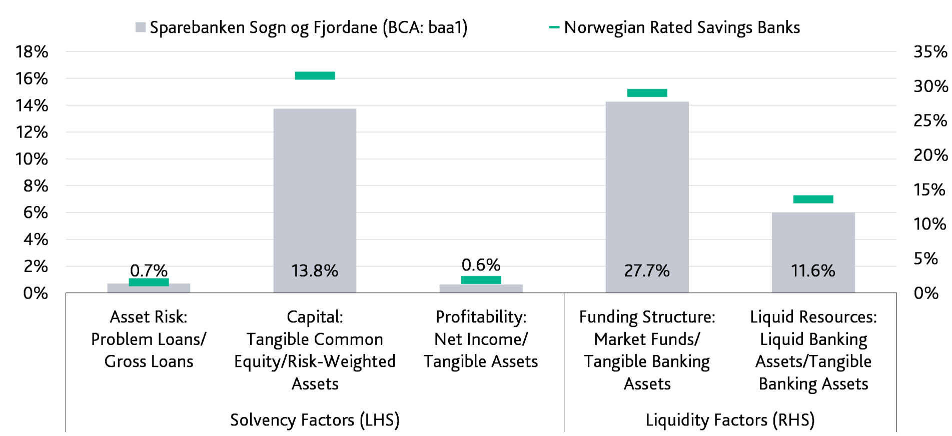
Summary Rating Rationale

We assign A2 long-term deposit and issuer ratings to Sparebanken Sogn og Fjordane (SSF). These incorporate two notches of rating uplift from the bank's baa1 standalone baseline credit assessment (BCA) based on our Advanced Loss Given Failure (LGF) analysis. LGF takes into account the risks faced by the different debt and deposit classes across the liability structure should the bank enter into resolution. The bank's ratings do not benefit from uplift based on our assessment of a low probability of government support. We also assign a Prime-1 short-term deposit rating and a Counterparty Risk Assessment (CR Assessment) of A1(cr)/Prime-1(cr).

SSF's baa1 BCA reflects the bank's Very Strong- operating environment, reduced problem loan levels that are in line with peers (with problem loans equivalent to 0.7% of gross loans at end-December 2016), improving capital metrics with a common equity Tier 1 ratio of 14.8%; but also its currently challenged profitability and relatively high reliance on the domestic capital markets. Our assessment of the bank also incorporates its high sector and credit concentrations, which could result in higher provisioning requirements as the operating environment is weaker, although we expect SSF's large residential mortgage portfolio to remain resilient.

SSF's deposit and issuer ratings carry a negative outlook to capture downward pressure on earnings and increased asset risk on the bank's corporate book as a result of the slowdown in Norway's economic growth.

Exhibit 1
Rating Scorecard - Key Financial Ratios (as of September 2016)



Source: Moody's Banking Financial Metrics

Credit Strengths

» Sparebanken Sogn og Fjordane's BCA is supported by its Very Strong- Macro Profile

» Capital levels are adequate and improving

» Problem loan levels have come down

» Large volume of deposits and junior debt resulting in deposit and issuer ratings benefiting from a very low loss-given-failure rate

Credit Challenges

» Profitability will continue to be challenged over the coming quarters

» There are elevated asset risks from sector and credit concentrations

» Market funding reliance renders the bank vulnerable to fluctuations in investor sentiment, despite a large deposit base

Rating Outlook

The negative outlook on SSF's deposit and issuer ratings reflects our expectation that the weakening profitability observed during 2015 and 2016, driven mainly by higher corporate loan losses in combination with margin pressure, will continue over the coming quarters.[1]

Factors that Could Lead to an Upgrade

» Upward rating momentum is currently limited given the negative outlook. Over time however, upward pressure could develop if the bank demonstrates: (1) sustained strong asset quality in its retail and corporate loan books, including in the more volatile segments, and a reduction in credit concentrations; (2) enhanced access to European capital markets and improved liquidity; and/or (3) stronger earnings generation without an increase in its risk profile.

» We may change the outlook on the bank's ratings to stable if profitability pressures abate and relevant metrics return to historical and sector norms and the bank's lending portfolio performs strongly during this slowdown period.

Factors that Could Lead to a Downgrade

» Future downward rating pressure would emerge if (1) SSF's problem loan ratio increases above our system-wide expectation of approximately 2%; (2) financing conditions become more difficult; (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors; (4) net profitability weakens, falling below 0.4% of tangible assets; and/or (5) the macroeconomic environment deteriorates more than anticipated, leading to a lower Macro Profile. Also, a reduction in uplift as a result of our LGF analysis could lead to downward rating pressure.

Key Indicators

Exhibit 2
Sparebanken Sogn og Fjordane (Consolidated Financials) [1]

	9-16[2]	12-15[2]	12-14[2]	12-13[2]	12-12[2]	Avg.
Total Assets (NOK billion)	48.6	45.9	42.6	39.6	37.1	7.0[3]
Total Assets (EUR million)	5,413.3	4,777.4	4,696.5	4,734.2	5,061.5	1.7[3]
Total Assets (USD million)	6,083.5	5,189.7	5,683.1	6,523.5	6,673.0	-2.3[3]
Tangible Common Equity (NOK billion)	3.6	3.4	3.2	2.9	2.6	8.6[3]
Tangible Common Equity (EUR million)	402.0	355.8	347.5	346.7	354.1	3.2[3]
Tangible Common Equity (USD million)	451.8	386.5	420.5	477.7	466.8	-0.8[3]
Problem Loans / Gross Loans (%)	0.7	1.1	1.8	1.3	1.6	1.3[4]
Tangible Common Equity / Risk Weighted Assets (%)	13.8	13.5	13.5	13.0	12.4	13.2[5]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.9	11.9	19.8	14.8	18.8	14.6[4]
Net Interest Margin (%)	1.6	1.7	1.8	1.7	1.7	1.7[4]
PPI / Average RWA (%)	1.9	1.8	2.3	2.4	2.4	2.2[5]
Net Income / Tangible Assets (%)	0.6	0.5	0.8	0.9	0.9	0.7[4]
Cost / Income Ratio (%)	45.0	46.7	41.2	39.4	40.4	42.5[4]
Market Funds / Tangible Banking Assets (%)	27.7	29.4	27.7	28.6	30.1	28.7[4]
Liquid Banking Assets / Tangible Banking Assets (%)	11.6	12.2	11.1	11.5	11.5	11.6[4]
Gross loans / Due to customers (%)	171.4	174.7	167.0	168.9	171.6	170.7[4]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] IFRS reporting periods have been used for average calculation [4] Compound Annual Growth Rate based on IFRS reporting periods [5] Basel II & IFRS reporting periods have been used for average calculation
Source: Moody's Financial Metrics

Detailed Rating Considerations

SSF'S BCA IS SUPPORTED BY ITS VERY STRONG- MACRO PROFILE

As a domestically focused bank, SSF's Macro Profile is aligned with that of Norway at Very Strong-. Banks in Norway (Aaa stable) benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrates resilience to the ongoing weakness in the oil sector. The main risks to the banking system stem from the high level of household indebtedness, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalization and the relatively small size of the banking system compared with the total size of the economy.

CAPITAL LEVELS ARE ADEQUATE AN IMPROVING

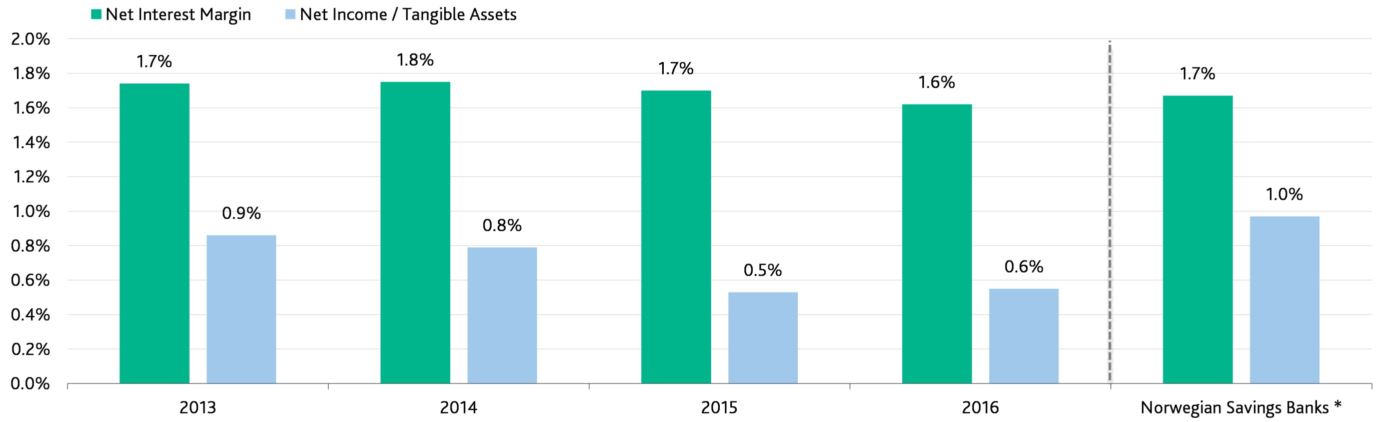
We consider SSF's capital levels as adequate for the bank's risk profile and in line with Norwegian peers. We also expect the bank's capitalisation to continue to increase, in line with stricter regulatory requirements. Specifically an increase to the countercyclical buffer for banks to 2% from 1.5% as of 31 December 2017.

The bank's tangible common equity to risk-weighted assets was 13.8% as of September 2016, up from 13.5% at the end of 2015. SSF also reported a common equity Tier 1 (CET1) ratio of 14.8% at year-end 2016 (which includes proposed dividends for the year). This ratio has improved from 13.7% in 2015, inline with the bank's internal target and higher regulatory capital requirements, reflecting mainly earnings retention and a private placement of shares to existing owners and employees in December 2016 of NOK69 million. The bank had set a target CET1 ratio of 14.5%, similar to other Norwegian savings banks. Our assigned Capital score reflects this strength, as well as the bank's tangible common equity / tangible banking assets ratio of 7.9% at end-December 2016, which compares well within international standards.

PROFITABILITY WILL CONTINUE TO BE CHALLENGED OVER THE COMING QUARTERS

We expect SSF's profitability will continue to face some pressure during 2017 as a result of the low interest rate environment, higher operating expenses and elevated loan loss provisions driven by the bank's corporate portfolio. SSF's profitability weakened significantly during 2015 and 2016 driven mainly by higher corporate loan losses in combination with margin pressure. Based on unaudited figures, we estimate that the return on tangible assets was 0.6% for 2016 (excluding one-offs; 0.5% in 2015). This is lower compared to 0.8% for 2014 and rated domestic peers (see Exhibit 3).

Exhibit 3
SSF's Profitability Metrics Evolution
Margins continue to be compressed and bottom-line profitability is lower than it was in the past and Norwegian peers



Note: * average of other Moody's rated Norwegian savings banks for the nine months to September 2016
Source: Moody's Banking Financial Metrics

During 2016 the, bank's net interest margin declined to 1.6% from 1.7% in 2015 due to lower margins on loans driven by continuous interest rate cuts by Norges Bank (the central bank) and domestic competition. Although there are indications that banks have started to reprice mortgage rates up after further reductions last year, we expect margin pressure to continue as Norges Bank indicated in its most recent Monetary Policy Report that the key policy rate will remain at around 0.50% for the next few years.

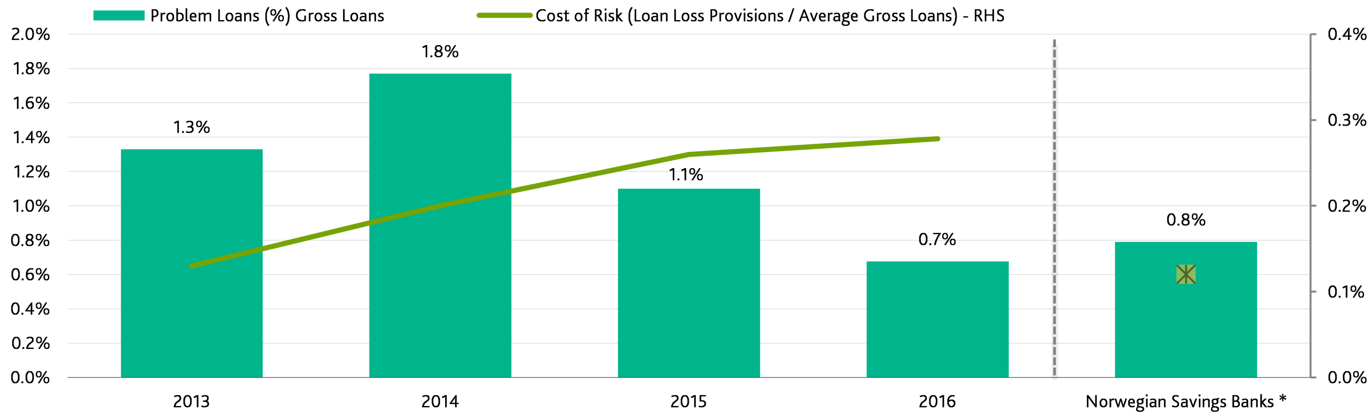
At the same time, loan loss provisions increased, with a cost of risk at 0.28% for 2016 according to the bank (0.26% for 2015, preceded by 0.20% in 2014 and 0.13% in 2013). Operating expenses have also increased by a high 8% during the year (excluding one-off effects) as the bank invested in IT. Although the bank has announced cost saving measures, such as the closure of 9 branches, we expect operating costs to remain elevated until the end of 2017 when cost savings will start to kick in.

Our assigned Profitability score reflects the bank's current profitability and our view that the more challenging operating environment will continue to put pressure on the bank's financial performance over the coming year.

PROBLEMS LOAN LEVELS HAVE COME DOWN. ELEVATED RISKS FROM SECTOR AND CREDIT CONCENTRATIONS

Our assessment of SSF's asset risk is driven by the balance of a reducing level of problem loans against the risks arising from credit concentrations and exposure to the volatile real-estate and construction sectors, as well as the economic slowdown in Norway. The bank's problem loan ratio (impaired loans and loans overdue by more than 90 days as a percentage of gross loans) decreased to 0.7% at end-December 2016 according to unaudited figures, down from 1.1% at end-December 2015 (see Exhibit 4), and is now in line with domestic peers. This decrease was attributable to the write-off of one non-performing corporate loan. The bank's problem loan coverage ratio was 73% at end-2016, while, as discussed earlier, credit costs remained elevated and higher than peers.

Exhibit 4
SSF's Asset Quality Evolution
The bank's problem loans have come down and are in line with peers, however cost of risk reamined elevated in 2016



Note: * average of other Moody's rated Norwegian savings banks at end-September 2016
Source: Moody's Banking Financial Metrics

The bank's portfolio mainly comprises retail customers, at over 70% of loans as of year end 2016. This lending category has performed well in the past and we expect it will remain resilient since, despite the risks from an increasing level of household indebtedness, we expect Norway's households to continue to service their debts as interest rates remain low and unemployment benefits remain generous. SSF has been growing its retail book more actively outside its home county (in Hordaland and other counties) driven by lower population growth in Sogn og Fjordane compared to other regions. We believe that, for the moment, the benefits of some regional diversification are balanced against the risks of managing this more diverse portfolio.

We see elevated risks from SSF's exposure to the real-estate and construction sectors, which stood at 12% of total loans as of December 2016. We note that the bank's overall exposure to oil-related business is low, at 1.4% of total loans. Similar to most of its Nordic peers, the bank exhibits high single-name concentration, which could heighten the pace and the extent of any deterioration in asset quality, which is reflected in our assigned Asset Risk score. Finally, we expect that the slowdown in economic growth in Norway will translate into some modest asset quality pressure for the bank.

MARKET FUNDING RELIANCE RENDERS THE BANK VULNERABLE TO FLUCTUATIONS IN INVESTOR SENTIMENT, DESPITE A LARGE DEPOSIT BASE

SSF's funding profile benefits from a sizeable deposit base (constituting 55% of non-equity funding at year end 2016 and more than 60% of the bank's deposits come from retail customers), however it is also significantly reliant on market funding, rendering it vulnerable to swings in investor sentiment. The bank draws most of this funding in the form of domestically-issued senior debt and covered bonds. Covered bonds are issued through the bank's wholly-owned covered bond company Bustadkreditt Sogn og Fjordane AS that was established in 2009.

Based on our methodology we reflect the stability of covered bonds relative to unsecured market funding through an adjustment to our market funds to tangible assets ratio and our adjusted ratio for the bank is 28% as of September 2016. However, we do not expect that SSF will have the capacity, in terms of size, to undertake larger benchmark issuances, ultimately restricting its investor base. Therefore, we reverse this adjustment for the bank (in line with other similarly-sized Norwegian savings banks) by assigning a Funding score based on the bank's higher unadjusted market funds radio of around 39%. As such, our assessment considers the bank's overall funding profile as a relative weakness.

We consider the bank's stock of liquid assets as broadly adequate, totalling 12% of tangible assets as of September 2016 (12% at the end of December 2015). Liquid assets mainly comprised government securities and covered bonds. We note that the bank's holdings are mostly Norwegian securities, which leads to concentration risk. Finally, the bank reported a Liquidity Coverage Ratio (LCR) of 120% at year end 2016.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, bank specific figures originate from bank's reports and Moody's Banking Financial Metrics. Moody's Banking Financial Metrics figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 12 February 2016.

Notching Considerations

Loss Given Failure

Norway is the process of transposing the EU Bank Resolution and Recovery Directive (BRRD) into local legislation and as such we consider the country an Operational Resolution Regime. In accordance with our methodology we therefore apply our Advanced LGF analysis, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our LGF analysis for the bank we use our standard assumptions and assume residual tangible common equity of 3%, losses post-failure of 8% of tangible banking assets, a 25% runoff in "junior" wholesale deposits, and a 5% run-off in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt.

Under these assumptions, SSF's deposits and senior unsecured debt are likely to face very low loss-given-failure, due to the volume of the deposits and senior debt themselves and the amount of debt subordinated to them. This results in a Preliminary Rating Assessment (PRA) of two notches above the BCA for both the deposit and issuer ratings of the bank.

Government Support

We do not incorporate government support uplift to SSF's deposit and issuer ratings as a result of the expected implementation of resolution legislation in Norway. SSF is a regional savings bank with a strong market position in the county of Sogn og Fjordane (Western Norway), where we estimate that it commands a 51% market share for lending and about 45% for deposits. Despite its dominant local position, the bank lacks geographical diversification and its national franchise is limited by a national market share of less than 2% (based on total lending nationwide, using Statistics Norway data). We therefore consider the probability of government support for Sparebanken Sogn og Fjordane's debt and deposits to be low (in line with similarly-sized domestic peers), resulting in no ratings uplift.

Counterparty Risk Assessment

We assign long- and short-term CR assessments of A1(cr) and Prime-1 (cr) respectively to SSF. CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity

Rating Methodology and Scorecard Factors

Exhibit 5

Sparebanken Sogn og Fjordane

Macro Factors		
Weighted Macro Profile	**Very Strong -**	**100%**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.2%	aa2	↓↓	baa2	Single name concentration	Sector concentration
Capital						
TCE / RWA	13.8%	a1	←→	a1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.6%	baa2	←→	baa2	Return on assets	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.4%	baa2	←→	ba2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	12.2%	baa3	←→	baa3	Stock of liquid assets	
Combined Liquidity Score		baa2		ba1		
Financial Profile				baa1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	**in-scope (NOK million)**	**% in-scope**	**at-failure (NOK million)**	**% at-failure**
Other liabilities	12,512	25.8%	15,052	31.0%
Deposits	24,899	51.3%	22,359	46.0%
Preferred deposits	18,425	37.9%	17,504	36.0%
Junior Deposits	6,474	13.3%	4,855	10.0%
Senior unsecured bank debt	9,203	18.9%	9,203	18.9%
Dated subordinated bank debt	500	1.0%	500	1.0%
Equity	1,457	3.0%	1,457	3.0%
Total Tangible Banking Assets	48,571	100%	48,571	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	33.0%	33.0%	33.0%	33.0%	3	3	3	3	0	a1 (cr)
Deposits	33.0%	4.0%	33.0%	23.0%	2	3	2	2	0	a2

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	2	0	a2	0	A2	A2

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SPAREBANKEN SOGN OG FJORDANE	
Outlook	Negative
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2

Source: Moody's Investors Service

Endnotes

1 See also our sector research "Banking System Outlook -- Norway: Lower Oil Investments Weaken Operating Climate, Driving Outlook to Negative From Stable", August 2016.

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